INDONESIA: ECONOMIC AND FINANCIAL HIGHLIGHTS
JANUARY-FEBRUARY 2005

Summary:

- The Government of Indonesia (GOI) raised its forecast for the FY 2005 budget deficit from 0.7 to 1.3 percent of GDP on February 18.
- Consumer price inflation rose to 1.43 percent on a month-on-month basis in January 2005 before again retreating slightly in February.
- Inflation was particularly high in tsunami-affected areas.
- Members of Parliament's Finance and Banking Commission questioned state-owned Bank Mandiri's recent writing off of IDR 2.72 trillion (USD 293.9 million) in non-performing loans (NPLs) at a February 15 hearing.
- Bank Indonesia issued a package of eight banking regulations on January 25 that aims to strengthen the banking sector's role in economic development, accelerate bank consolidation, and improve the architecture of the banking system.
- On February 7, President Yudhoyono signed a Presidential Decree creating a Secondary Mortgage Facility.
- The Ministry of Finance sold IDR 3 trillion in 12-year rupiah bonds at a weighted average yield of 10.42 percent on February 22.

New Budget Assumptions

On February 18, the Government raised its forecast for the FY 2005 budget deficit from 0.7 to 1.3% of GDP. This was accompanied by a series of changes in budget assumptions.

	New Budget Assumptions	Previous Assumptions
Average oil price (US$/b)	USD 35	USD 24
Real GDP	5.5%	5.5%
CPI Inflation	7.0%	5.5%
USD/IDR (avg)	8900	8600
3month SBI rate (avg)	8.0%	6.5%
Budget deficit (% of GDP)	1.3%	0.7%

Inflation Climbs in January, Retreats in February

On February 2, the Central Statistics Bureau (BPS) announced that January consumer price inflation had climbed 1.43% MoM, up from 1.04% the previous month and the highest level in two years. The YoY figure of 7.32% is also higher than expected, and will make more challenging the Government of Indonesia's (GOI) goal of keeping inflation at 5.5% or lower in 2005 (Inflation for 2004 was 6.4%). Analysts had projected a much lower January CPI of 0.3 - 0.95% MoM and 6.1 - 6.8% YoY. Nationwide, the highest increase of 3.11% was in basic food prices, with housing and utilities rising by 1.48%. February inflation retreated slightly at 1.26 MoM and 7.15 YoY.

Some analysts voiced concern that 2005 inflation will exceed the GOI's targeted rate of 6.5 - 7.0%. Economists estimate inflation will continue to rise in the first half of 2005 due to fuel subsidy cuts implemented on March 1. The GOI cut subsidies on all fuels except home kerosene by a weighted average of 29%. However, a relatively stable rupiah should help contain inflation, and wage pressures are expected to remain subdued due to continued high unemployment and underemployment.

Inflation Surges in Tsunami-Affected Areas

The tsunami disaster led to significant food price increases in Aceh province. Provincial inflation of 7.02% (MoM) was far higher than the nationwide inflation rate, although this figure only reflects data from two provincial cities, Banda Aceh and Lhoksaumawe. There are reports that the large presence of donors and NGOs are driving up land, housing and commodity prices in Aceh. The January inflation rate in North Sumatra, the other tsunami-damaged area reached 2.82%, with food price increases of 5.84% as the largest contributing factor.

Bank Mandiri Writes Off NPLs

In a February 15 hearing, members of Parliament's Finance and Banking Commission (Commission XI) questioned state-owned Bank Mandiri's recent writing off of IDR 2.72 trillion (USD 293.9 million) in non-performing loans (NPLs). Commission member Dradjat H. Wibowo claimed that 13 state-owned enterprises (SOEs) have failed to make required payments on IDR 1.37 trillion (USD 148 million) of loans from Indonesia's largest bank. Of the total amount, IDR 890 billion (USD 96.2 million) is still listed on Mandiri's balance sheet while the remaining IDR 483 billion (USD 52.2 million) has been written off.

Delinquent Mandiri borrowers include state-owned enterprises (SOEs) such as cement manufacturer PT Semen Kupang (IDR 159 billion); PT Merpati Nusantara Airlines (IDR 203 billion or USD 17.2 million); plantations PTPN II (IDR 256 billion, or USD 27.7 million) and PTPN XIV (IDR 31 billion, or USD 3.3 million); and paper company PT Kertas Kraft Aceh (IDR 153 billion, or USD 16.5 million). Dradjat said these write-offs are "like time bombs" and that the Ministry of State-Owned Enterprises as the majority shareholder of Bank Mandiri, together with Bank Indonesia, should undertake immediate steps to stop this practice. Despite the write-offs, Bank Mandiri's NPLs are still higher than other state-owned banks such as BNI and BRI. Mandiri is Indonesia's largest bank with assets of IDR 228.7 trillion (USD 24.5 billion) as per September 2004 and about 25% of market share.

New Banking Regulations

BI issued a package of eight regulations on January 25, 2005 with the stated goals of strengthening the banking sector's role in economic development, accelerating bank consolidation, and improving the architecture of the banking system. Key regulatory changes include the following. (Note: The Indonesian language text of the regulation package can be found at www.bi.go.id)

BI Regulation No. 7/2/PBI/2005 on the Valuation of Earning Assets Quality amends the criteria for banks to follow in assessing business viability. Its objective is to stimulate bank lending to small and medium enterprises (SMEs) and micro businesses, especially in Aceh, Maluku, and Papua. While the previous regulation assessed project viability and borrower performance, the new regulation looks only at borrowers's ability to repay principal and interest. This regulation also extends the scope of collateral banks may consider when lending.

BI Regulation No. 7/3/PBI/2005 raises the maximum Legal Lending Limit (LLL) for commercial banks to unaffiliated parties from 20 to 25% of bank capital for private projects and to 30% for government infrastructure projects implemented by state-owned enterprises.

BI Regulation No. 7/5/PBI/2005 on "Special Treatment for Commercial Bank Loans After the National Disaster in Aceh and Nias" outlines more flexible terms for assessment and classification of loans to the tsunami-affected areas.

BI Regulation No. 7/8/PBI/2005 outlines a Debtor Information System and obligates banks to report complete information on borrowers. BQ will consolidate the information to give banks access to better customer information, lowering lending risk.

BI Regulation No. 7/7/PBI/2005 establishes an improved process for Customer Claim Settlements. There has long been a need for better consumer protection given recent bank failures and fraud. This new regulation obliges banks to establish a special unit along with transparent procedures to receive, manage, monitor, and settle customer claims.

BI Regulation No. 7/6/PBI/2006 on Product Transparency and the Use of Customers' Personal Data requires banks to disclose the terms and conditions of their products transparently and comprehensively.

Banking Mergers and Consolidation

In a January 14 speech, BI Governor Abdullah announced that BI would accelerate bank consolidation. BI followed up the Governor's speech by issuing

Regulation No. 7/3/PBI/2005, which removes the 10% restriction on the amount of capital that one bank can inject into another. This regulation is aimed at consolidation of Indonesia's 52 small banks with less than USD 11 million in capital, and contains incentives for them to merge with healthier "anchor banks."

Although the regulation is aimed at private banks, President Commissioner Binhadi of Bank Mandiri said the bank might target a smaller domestic commercial bank for acquisition. One possible merger of state-owned banks under discussion is between Bank Negara Indonesia, Indonesia's second largest bank (with 13% of market share) and the smaller Bank Tabungan Negara (BTN). BTN is Indonesia's eighth largest bank with about 2.5% of market share. BNI President Director Sigit Pramono stated that his bank has submitted a merger proposal to the Ministry of State-Owned Enterprises. He also stated that in case of merger, BTN's focus on mortgage lending would remain unchanged.

Presidential Decree on Secondary Mortgage Facility

On February 7, 2005, President Susilo Bambang Yudhoyono signed Presidential Decree No. 19/2005 for a Secondary Mortgage Facility (SMF). The decree calls for alternative sources of financing to meet Indonesia's public housing deficit, estimated at approximately 800,000 units. The government has set an extremely ambitious target of building 225,000 new units of low-income housing in 2005.

GoI Sells IDR 3 trillion in 12-year Bonds

In its second auction of GOI sovereign bonds this year, the Ministry of Finance (MOF) sold IDR 3 trillion (USD 326 million) of 12-year bonds on February 22 at a weighted average yield of 10.42%. The bonds' 12-year maturity is the longest to date for GOI sovereigns. The MOF's first auction of 2005 was a January 25 sale of IDR 2 trillion (USD 217 million) in 10-year bonds with a weighed average yield of 10.12%. The January bond offering was heavily oversubscribed with investors submitting IDR 12 trillion in bids.

According to the FY 2005 budget, the Government plans to issue IDR 43 trillion (USD 4.67 billion) of both IDR and dollar bonds this year. Parliament has given GOI financial authorities the flexibility to determine the terms and conditions of the bonds it issues. As a comparison, in 2004, the GOI conducted nine bond auctions with a total issuance of IDR 23.6 trillion (USD 2.56 billion).

Selected Economic Statistics

	Nov 04	Dec 04	Jan 05
CPI Inflation (YoY)	6.18	6.40	7.32
CPI Inflation (MoM)	0.89	1.04	1.43
Rp/USD Exchange rate	9,018	9,290	9,165
30-day SBI Interest Rate	7.41	7.43	7.42
Foreign reserves (USD billion)	25.51	26.35	26.01
Exports (USD billion)	5.17	6.45	6.13
% Change (YoY)	*9.99*	*11.49*	*21.63*
Import (USD billion)	3.71	4.81	4.01
% Change (YoY)	*40.01*	*29.48*	*19.81*
Trade Balance	1.46	1.64	2.12

Source: Bank Indonesia, BPS

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